



EMEA Investment grade examined 2026

The importance of
portfolio construction

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Executive summary

Heading into 2025, markets expected a transition towards monetary easing as inflation cooled and growth moderated. That broad roadmap played out, although the path was uneven. In the US, the Federal Reserve (Fed) delivered further rate cuts, as did the Bank of England. The European Central Bank, however, shifted firmly into a “hold” stance after a sequence of cuts.

It was another eventful year geopolitically. US president Donald Trump’s “Liberation Day” tariffs in April 2025 imposed a sweeping 10% baseline tariff on nearly all imports, with higher country-specific rates to follow. Markets reacted sharply, with investment grade (IG) yields spiking to a peak of almost 120 basis points (bps) versus 93bps pre-tariffs. As policy rhetoric softened, IG responded well, with spreads in the US reaching 25-year lows, tightening to roughly 0.75% over Treasuries by August.

Looking ahead, 2026 will be defined by dispersion, shaped by three macro themes: asynchronous monetary policy; an expansion in corporate capex around artificial intelligence (AI); and shifts in supply-demand dynamics. The surge in AI infrastructure spending is particularly important. As hyperscalers

fund global data centre, grid and network expansion, supply is expected to rise but remain manageable. AI-linked issuance is expected to be a meaningful but orderly driver of IG supply rather than a destabilising wave.

Valuations enter 2026 a little on the rich side, with global IG spreads well below long-run averages and both US dollar and euro markets modestly expensive on a quality and duration-adjusted basis. Even so, technicals remain supportive: IG still offers an attractive yield premium over equities, while strong demand from long-horizon investors – for example, fully funded pension schemes – continues to anchor spreads and limit widening pressure.

However, the tightening we saw in 2025 suppressed dispersion, compressing spread differentials across quality tiers. With spreads already rich, the upsides from further tightening are now asymmetric. In a more volatile or supply heavy environment – particularly if debt-funded M&A accelerates or AI capital expenditure (capex) proves uneven – lower quality bonds could widen faster.

IG in 2026 is therefore poised for solid, carry-driven total returns, but with greater differentiation under the surface. We entered 2026 close to neutral overall risk and favouring higher quality issuers, the seven- to 12-year part of the curve, and senior over subordinated capital structure risk. Market leadership should rotate towards resilient balance sheets, regulated or infrastructure-linked sectors, and issuers positioned to navigate a new, more selective credit regime.

In short, while 2025 rewarded beta, 2026 will reward portfolio construction.



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Macro backdrop

Monetary policy

Our economic outlook remains broadly constructive. The global economy demonstrated notable resilience throughout 2025, and we expect the coming year to be characterised by an effort to “extend the cycle”. This will likely see support from both fiscal and monetary policy measures aimed at sustaining growth at or slightly above 2025 levels.

Fiscal stimulus is set to play a key role in several major economies. Japan and Germany have already announced substantial packages, while in the United States the “One Big Beautiful Bill” passed in 2025 is expected to deliver a meaningful boost. China is also likely to implement incremental measures to keep growth on track towards its 5% target.

Monetary policy divergence will be a defining feature in 2026. We anticipate further rate cuts in the US, with the possibility of an accelerated pace in the US should a more dovish Fed Chair be appointed by Trump. In the UK, two additional cuts appear likely over the course of the year. Meanwhile, eurozone rates are expected to remain on hold barring unforeseen developments, while Japan is moving in the opposite direction, with rate hikes anticipated as the Bank of Japan gains confidence that inflation is firmly anchored near its 2% target.

Economic growth

We expect solid global growth in 2026. Germany should see a notable pickup, supported by fiscal stimulus, while China is expected to maintain its 5% growth target. US growth is likely to remain broadly in line with 2025, with upside potential from additional stimulus. The UK outlook remains subdued, with below-trend but still positive growth. Overall, conditions appear supportive for another year of steady expansion, which in turn should drive positive corporate earnings growth.

Tariffs remain a structural feature of the global landscape, though their form may evolve. While the US Supreme Court ruling could influence implementation, alternative legal avenues exist for the administration to maintain tariff measures. Global supply chains have adapted to the new regime, and the economic impact has been relatively contained, helped by exemptions and reductions from headline rates compared to initial fears earlier in 2025.

Both equity and bond valuations enter 2026 at elevated levels, leaving limited room for error. The dominant AI theme introduces additional risk, as some companies may struggle to meet lofty growth expectations. This year could mark a shift toward monetisation and returns on significant AI-related capex.

In terms of known political events, the US mid-term elections will be a focal point, determining Congressional control and shaping the final two years of Trump’s term. In the UK, local elections typically have limited market impact, but given perceived vulnerabilities in the Labour leadership, they may carry greater significance for both the prime minister, Keir Starmer, and the chancellor, Rachel Reeves.

Japan’s prime minister, Sanae Takaichi, called an early election in February, which she duly won. Her Liberal Democratic Party secured more than 310 seats and achieved a two-thirds supermajority in the lower house. This decisive mandate strengthens her ability to advance plans for increased spending, tax cuts and an accelerated security strategy. Markets reacted sharply as the implications of her policy agenda unfold, with Japanese government bond yields continuing to face upward pressure amid expectations of significant fiscal expansion.

While the scheduled political calendar appears relatively light, unforeseen developments could influence markets. As a reminder, last year we saw Ukraine president, Volodymyr Zelensky, defenestrated in the Oval office, the US air force bomb Iran’s nuclear facilities, and Russia president, Vladimir Putin, given a red-carpet welcome in Alaska. Already in 2026 we have seen the Davos conference dominated by discussion over the future of Greenland (and consequent back and forth on tariffs).

None of these events could have been predicted at the start of last year. Whilst markets proved to be relatively resilient in the face of these events, there is no guarantee that this will always be the case. Like the Jenga tower, we cannot know which brick will be the one that might trigger a dramatic reaction.

Fundamentals

Corporate fundamentals

We aggregate all our analysts’ individual models to get an overall trend across our coverage universe – ie this is not based on an index, but rather our coverage, and represents approximately 70% of the risk in EUR, GBP and Global IG indices.

Broadly speaking, we continue to expect strong fundamentals with leverage expected to stay near decade lows. Globally, we forecast revenue growth for this year of 3% and EBITDA (earnings before interest, taxes, depreciation and amortisation) growth of 6.5% – similar numbers to 2025. This will take net leverage (pension and lease adjusted) from 1.9x to 1.7x by the end of 2026 – the lowest in more than a decade. In 2025, interest coverage was around 12.5x globally. We expect it to improve by around 100bps this year. With leverage low and modestly falling, and interest coverage still high and climbing, this is supportive for credit spreads.

Here we drill down into what is driving this at a sector level:

Building materials

= NEUTRAL Sector fundamentals remain resilient, with strong pricing offsetting volume declines and supporting profitability and solid credit metrics. Growth is driven by EU Emissions Trading System regulatory shifts and transformative M&A reshaping business profiles. With a firmer macro backdrop and ongoing consolidation, construction activity is set to recover, benefiting IG issuers.

Capital goods

= NEUTRAL Business prospects across a wide range of manufacturers look more balanced than has been the case in recent years. The business activity “pause” that was a consequence of the US government’s tariff and trade policies should improve, or at least not worsen year-on-year. Significant large positive impetus will arise from both government fiscal policies in many G7 economies and the multiplier effect from commercial aviation as engine bottlenecks subside and Boeing factory lines increase production rates. Were we to see an exogenous catalyst – for example, lower interest rates or a peace agreement leading to stability in Ukraine – that would likely make the “neutral” appear too cautious.

Communications

↑ POSITIVE US telecommunication providers are spending to improve wireless/5G reach, expand fixed-wireless access, and expand fibre footprints. This should provide a nice backdrop to compete against traditional cable broadband. Combined with a promotional environment focused on handsets rather than service revenue, there should be room for telecoms operators to continue growing wireless revenue and gaining broadband subscriber share. While cable is facing subscriber pressure from new sources, they continue to have opportunities to improve cash flow via falling content costs (fewer TV subscribers) and cost efficiencies.

In Europe, earnings growth continues to be supported by convergence, the uptake of fibre and moderating capital intensity (less than 16% capex/sales) improving cash flows. In our view, the sector is also a quiet winner from AI. However, limited deleveraging is expected, which given an increased focus on shareholders and increasing acquisition risk, gives a stable score. The latter is driven by the desire for growth given that the sector remains fragmented and highly competitive.

Consumer

↓ NEGATIVE We expect the food and beverage sectors to experience divergent performance across subsectors. Packaged food companies face the most pressure as net leverage ratios continue rising due to compressed EBITDA margins and declining topline growth. This causes total EBITDA dollars to shrink faster than companies can reduce net debt. Non-alcoholic

beverage companies should outperform food peers given healthier volume and pricing dynamics along with better margin stability. Alcoholic beverage companies face ongoing volume declines in the critical US market, though the rate is moderating with intermittent signs of stabilisation. Across the broader consumer packaged goods sector, margin compression is anticipated due to tariff-driven input-cost inflation, increasingly price-sensitive consumers, and heightened competitive pressures. The M&A environment is intensifying as companies seek to acquire growth opportunities in what has become a more normalised consumer demand landscape.

Energy

= NEUTRAL Expectations are for weak oil macro in 2026; however, IG energy issuers begin the year with very healthy balance sheets. While weaker oil prices are likely to pressure margins, cash flows will be supported with less spending. Midstream remains insulated, supported by contractual protection and insatiable demand for natural gas services.

Healthcare

↑ POSITIVE Within healthcare, we are becoming more constructive on the outlook for managed care. Many of the headwinds that weighed on the sector in 2025 are, if not turning into tailwinds, at least beginning to ease. Companies are either exiting or aggressively repricing their healthcare exchange businesses, Medicare Advantage reimbursement rates in the US are shifting from negative territory to approximately +5%, and while Medicaid will remain unprofitable, its drag on earnings should be reduced. Additionally, the political environment for pharmaceuticals has improved significantly, with major players reaching economically manageable pricing agreements with the US administration.

Information services

↑ POSITIVE This sector continues to perform well with credit metrics remaining strong despite AI concerns. Generative AI is likely to be an opportunity rather than a threat given the ownership of proprietary databases and critical data supporting need-to-know client workflows. Key risks remain around cybercrime and data breaches, but strong balance sheets help offset this. We continue to not expect deleveraging but an ongoing commitment to leverage targets.

Media

↓ NEGATIVE We continue to see positives for streaming services, particularly those with a global reach. That said, advertising dollars continue to migrate away from television towards other platforms such as social media and the internet. Traditional TV will be challenged by ongoing cost increases from sports spread across a shrinking viewership base, particularly across cable channels. While overall there remain more headwinds than tailwinds, free cash flow will likely be used to preserve balance sheets.

Metals and miners

= NEUTRAL Metals and mining fundamentals remain broadly neutral, underpinned by resilient demand and elevated copper, gold and silver prices. Supply and production growth are limited, but balanced markets and pricing strength support healthy returns. Iron ore lags amid oversupply and softer Chinese demand, though sector credit metrics remain robust.

Real estate

= NEUTRAL The IG real estate sector enjoyed sound fundamentals through 2025 with stable occupancy, improved balance sheets, stable asset valuations and modest positive rental growth. Meanwhile bond issuance volumes returned to pre-pandemic historical levels. For 2026 we are forecasting revenue growth and stable capex combined with modestly lower leverage and loan-to-values. We maintain a neutral stance on offices and retail, are constructive on data centres and residential, and have turned modestly negative on logistics.

Technology

↑ POSITIVE AI drives broad operational positives for compute chip makers, public cloud providers, AI software implementation, consulting and consumer hardware. Many of these potential benefits will be funded by the largest and lowest leveraged institutions in the technology space – the hyperscalers. This is a potential win-win as AI adoption drives more cloud use, which in turn funds the capacity to drive more improvements via AI models. Alternatively, if AI monetisation stalls, there is potential for incremental cash flow from unspent capex, thus benefiting credit metrics even if there is not incremental AI growth at the top-line.

Tobacco

= NEUTRAL Tobacco continues to perform well with no real changes to the industry dynamics of combustibles pricing offsetting low single-digit percentage volume declines and

growth from next generation products. Key risks remain around regulation, although this is arguably less negative than before. Leverage targets remain in place with PMI and BAT¹ still focused on deleveraging.

Utilities

= NEUTRAL The outlook for utilities in 2026 is constructive due to supportive regulation and increasing use of equity to fund capex. Spending is expected to increase 20%-30% in 2026 over the already elevated 2025 levels. This will drive an active regulatory calendar and concerns about rising customer bills. Data centers are expected to fund their share of utility infrastructure and generate incremental load that should improve affordability for retail customers. While select names face execution risks, sector credit metrics are expected to remain stable or modestly improve in 2026.

What about M&A?

M&A is often difficult to predict. A useful way to look at it is to measure the completed deal volumes relative to nominal GDP (Figure 1). On this metric, transactions have been running at around 3% of GDP for the past three years compared to a long-run average of 4.8%. This is the lowest level since the mid-1990s. As the interest rate picture becomes more stable, we are alert to the possibility of a continued cyclical upswing in M&A. We saw a flurry of activity in the telecoms, media, banking and mining sectors (we dive into sector specifics in more detail on p12).

Several conditions are in place to support a rebound in M&A, particularly in the US, which could lead to deterioration in credit fundamentals. However, the key question is how that would be funded. With higher yields compared with pre-2022, the cost of big debt-funded M&A has also increased. Leveraged buyout data shows a rise in equity contributions during the interest rate hiking cycle to around 50% in 2023, compared with a post-global financial crisis average of 40%. That number fell back towards 40% in 2025.

Figure 1: Global completed M&A relative to GDP



Source: Bloomberg/Autonomous, 31 December 2025

1. Mention of specific stocks is not a recommendation to buy or sell.

Management teams in more cyclical sectors, for example mining and autos, have built up cash buffers to protect balance sheets should the cycle turn. It is not our base case that these will be used to fund big transactions. Talking to management teams, we do not get the sense that they are likely to re-leverage in a higher yield environment to fund M&A. We would therefore expect to see a sizable portion of deals funded with equity, perhaps offset by reducing buy-backs.

To conclude on corporate fundamentals, while we acknowledge the potential for a rise in M&A and challenges in the auto sector, we think corporate fundamentals are strong. In several sectors, balance sheets are improving.

Bank fundamentals

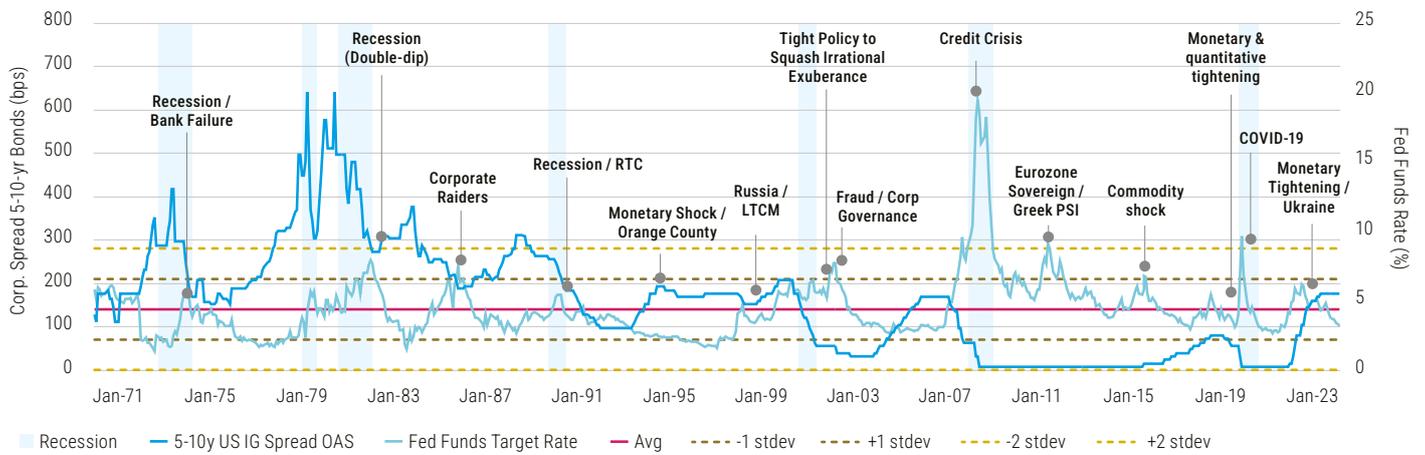
Banks account for about 35% of the risk in the credit index. Following more than 15 years of fundamental improvement at a global level, European and US approaches are starting to diverge. As a team we are more comfortable with European banks than US banks.

In Europe, capital is plateauing at multi-decade highs. European banks are around 400bps ahead of regulatory minimums. Asset quality remains benign. In our forecasts, we expect the cost-of-risk (a forward-looking measure of losses from lending) to remain slightly below normalised levels.

In the US, deregulation is in full swing. We expect capital ratios to fall next year and buffers to regulatory minimums to compress. Our base case for asset quality remains benign. The primary driver of future credit losses is unemployment, and labour markets are forecast to remain robust. However, the tail risk in the US has increased as banks rapidly expand non-depository financial institutions (NDFI) lending (see the Themes section for more detail).



Figure 2: Long-term US dollar IG spread with associated recessionary periods



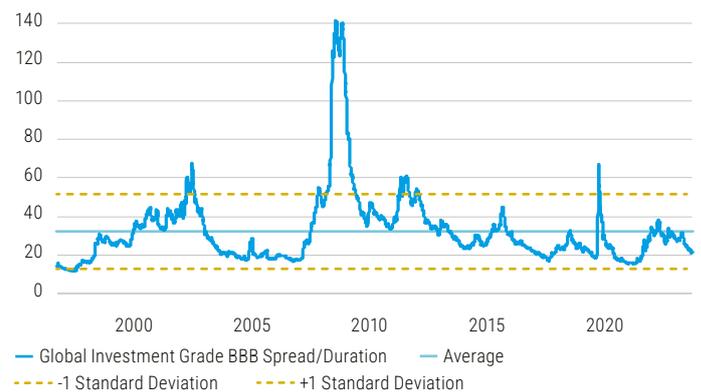
Source: Bloomberg, Merrill Lynch, C6A0 index, as of 31 December 2025

Valuations

There are many ways to assess the relative value of credit spreads. Given the mean-reverting nature of the asset class, looking back through history is typically the starting point. We have 50 years of data for US dollar 5-10-year IG spreads (Figure 2). Over time global corporate credit spreads over government bonds average around 140bps, with a median of 125bps. However, note that credit spreads spend most of their time trading through their long-run average, with periods of aggressive widening (2008-09, 2011, 2015, 2020 and 2022), which highlights the asymmetric nature of credit. At the end of 2025, spreads were 87bps.

A better way to look at it, in our opinion, is to adjust for composition changes over time to take into account that the credit quality and the duration of the index changes over time (Figure 3). One way to do this is to look at the spread per unit of duration on the BBB sub-segment of the index (which you can think of as the break-even spread that would cancel out one year of carry from investing in credit over government bonds, 98/5.7 = 17bps). On this metric, global IG is about 0.7 standard deviations rich, driven by US dollar IG spreads 0.7 standard deviations rich and euro spreads about 0.6x rich.

Figure 3: Global BBB spread / duration



Source: Macrobond, BofAML Indices and Columbia Threadneedle Investments, 31 December 2025

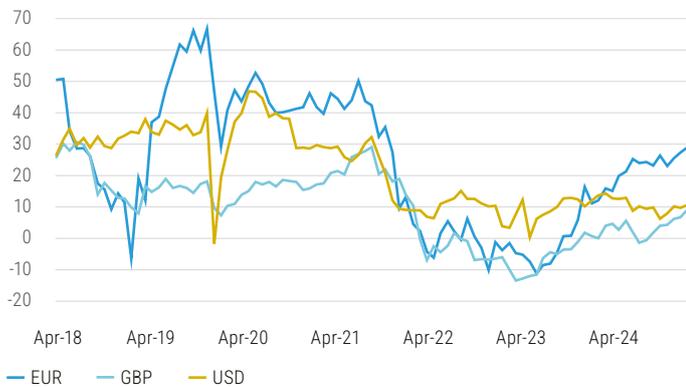
The purest expression of corporate credit spreads, however, is to look at the credit spread to swaps (the yield differential between corporate bonds and swap rates). This excludes the difference between swaps and government bonds, which is partly driven by systemic risk and expected supply/demand of government bonds, which in turn are impacted by quantitative easing (QE), quantitative tightening (QT) and repo markets etc, which are not “pure credit risks”. On this metric, global BBB-rated credit spreads by unit of duration are 0.6 standard deviations rich.

Credit spreads are not normally distributed and tend to spend most of the time being a bit rich to average and median. As such it is worth bearing in mind that, over the past 25 years, the global BBB spread per unit of duration has spent more than 30% of the time being 0.5 standard deviations rich and more than 15% of the time 0.75 standard deviations rich.

Credit curves

Under the surface, we also consider the relative valuation of different parts of the credit market. One way to do that is to compare how much additional spread is available at different maturities. Traditionally, one would expect credit curves to be upward sloping as lending for longer typically involves higher uncertainty and risk of credit deterioration. However, that differential (also known as the steepness of the credit curves) changes over time depending on demand/supply dynamics. This can be a source of alpha for investors. Since the increase in interest rates in 2022, credit curves flattened across major markets and have remained as such (Figure 4).

Figure 4: 10s 30s steepness by currency

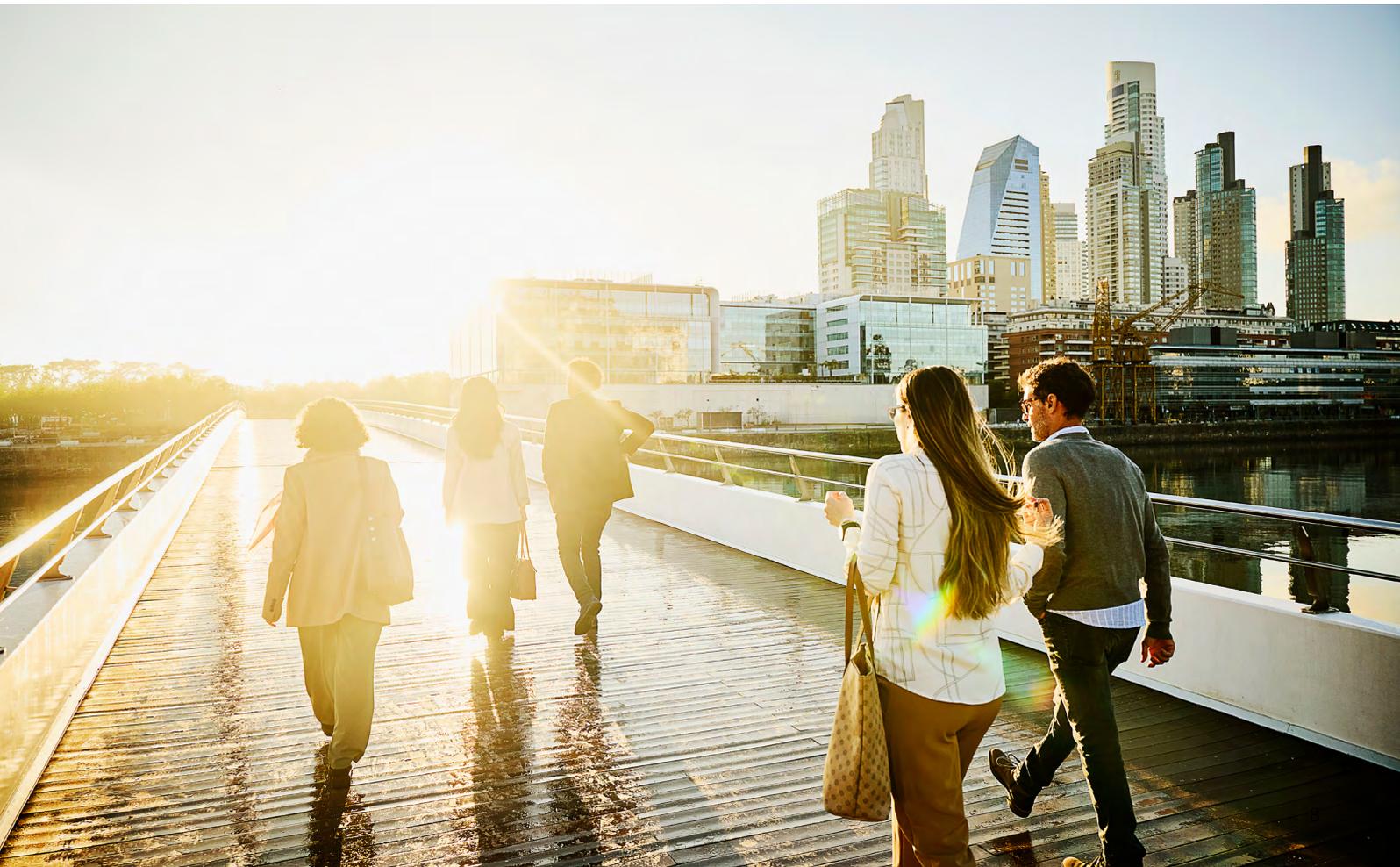


Source: Bloomberg, as of 12 January 2026

This is partly driven by a reduction in supply at the long end (issuers potentially looking to avoid locking-in for a long time what they might perceive as elevated yields), while investors – especially yield-focused investors – have been looking to do exactly that, lock in higher yields for longer. Another aspect is that since yields have risen, the price of long-dated bonds issued before 2022 has fallen. From an investor perspective, this offers a potentially interesting opportunity as many of these bonds are now trading below par, which would cushion any losses in the case of a default and offer higher convexity.

A potential catalyst for a re-steepening of credit curves could be an increased issuance of longer-dated bonds either to fund M&A transactions or as hyperscalers issue across maturities to fund AI capex.

As the additional spread (ie compensation) on longer-dated bonds compared to intermediate maturities is low, we maintain a cautious view on the former.



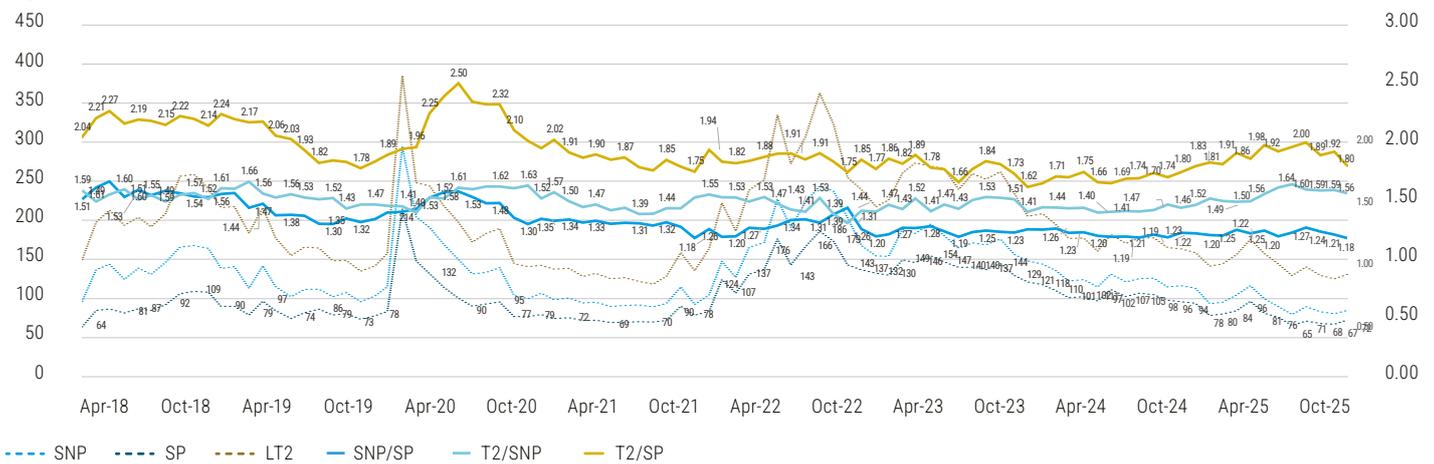
Capital structure thoughts

Another source of alpha is exploiting differences between bonds of varying subordination – ie across the capital structure. This is most common within banks as they are required by regulation to build out layers of bonds of varying subordination. Most corporate issuers stick with senior unsecured bonds, but banks have senior preferred (SP), senior non-preferred (SNP), subordinated (SUB) and junior subordinated bonds. The default probability and recovery rates vary greatly between these layers.

Currently, we think that both the SUB/SNP ratio is around fair value at 1.5x while the SNP/SP ratio below 1.2x looks low. This suggests the additional compensation on SNP versus SP bonds is low, which is reflected in our portfolio construction (Figure 5).

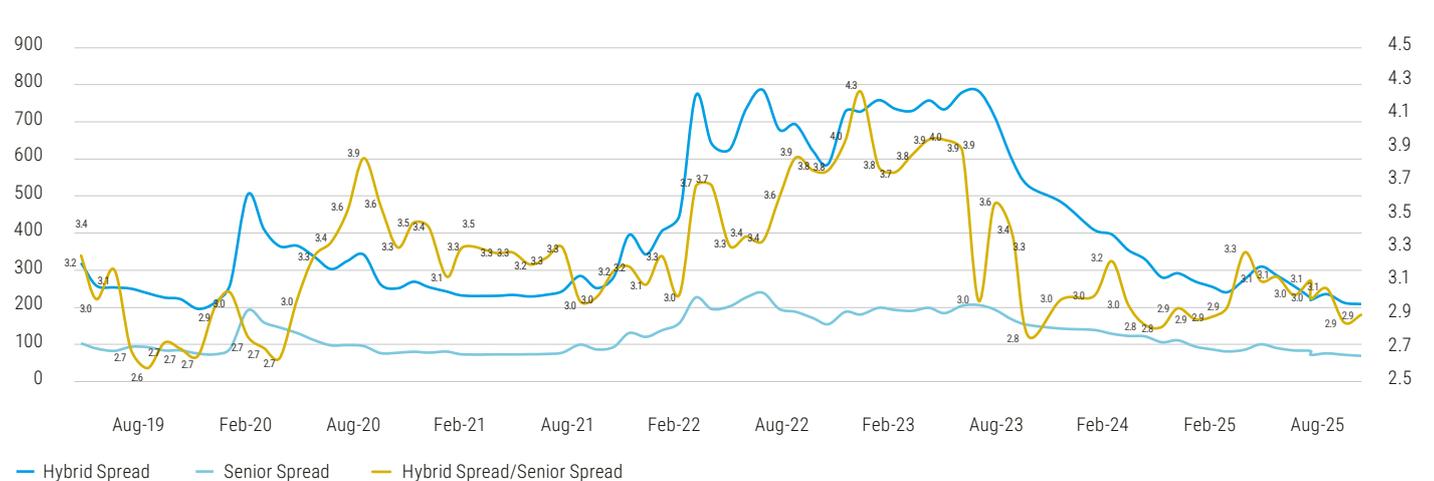
Turning to corporate hybrids, we assess their relative value by looking at the spread ratio to senior spreads. Since the compression in this ratio in the second half of 2023 it has remained relatively stable between 2.8x and 3.2x. Corporate hybrids underperformed senior bonds in Q125, but since the Liberation Day sell-off they have resumed their grind tighter, pushing this ratio back down to 2.8x. This remained the case until the very end of the year when they widened to around 3x (Figure 6). As the compensation for taking additional subordination risk is relatively low, we continue to have a broad preference for senior bonds.

Figure 5: Spread ratio across capital structure



Source: Bloomberg, BofAML Indices and Columbia Threadneedle Investments, 31 December 2025

Figure 6: Corporate hybrids



Source: Bloomberg, BofAML Indices and Columbia Threadneedle Investments, as of 31 October 2025

Sentiment and technicals

Supply/demand

A useful measure of the supply-demand balance is to look at net issuance of IG bonds in the primary market (as a measure of supply) minus fund flows into IG ETFs and mutual funds (a measure of demand). On this metric, things look good relative to history: there has been more cash coming into the IG asset class than new bonds to invest the cash into.

In our opinion, one of the most important metrics to demonstrate the technical picture is the yield offered by IG credit relative to equities. The picture here is as good as it has been for 20 years. Yields on global credit are around 4.4% versus the earnings yield on the S&P 500 of around 3.7% (Figure 7).

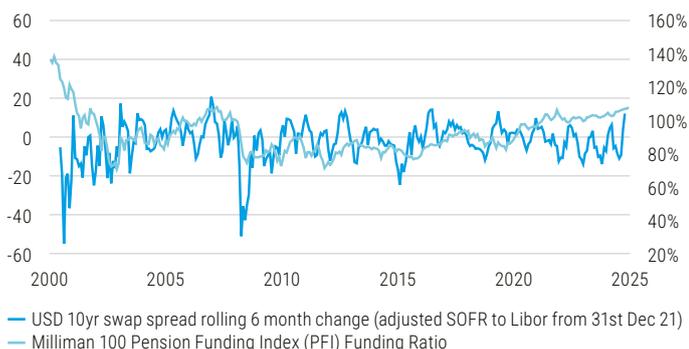
Figure 7: Global IG yield versus S&P 500 earnings yield



Source: Bloomberg and Columbia Threadneedle Investments, 31 December 2025

Another useful measure is to look at demand for duration assets from pension funds. Figure 8 demonstrates that pension funds are now fully funded, with assets greater than liabilities. As such, managers will want to lock-in that funding ratio. To do this they either buy short-dated credit and receive fixed-on long-dated swaps, or they buy long-dated credit. This has the effect of making swaps and credit tighter relative to Treasuries – providing a strong technical support to IG.

Figure 8: Pension funds funded status



Source: Bloomberg and Columbia Threadneedle Investments, as of 31 December 2025

Finally, as we argued last year, a steeper yield curve should have a positive impact on demand for credit, in so far as the yield pick-up on IG versus cash increases. For example, an investor might have questioned investing in IG in 2024 when the yield on cash was above the yield available in global IG (at the start of 2024 the yield on global IG was around 4.75% compared to the Fed Funds Target rate of 5.5%). However, as central banks have cut interest rates and yield curves have steepened, that picture was very different by the end of 2025. The yield on global IG is now around 4.4% compared to the Fed Fund Target rate of 3.75%. The longer this remains the case, or central banks cut rates further, and the yield curve remains steep, this technical support for the asset class should remain. This alone would not be enough to argue that supply/demand dynamics are supportive for IG, but it is another argument supporting the favourable backdrop.

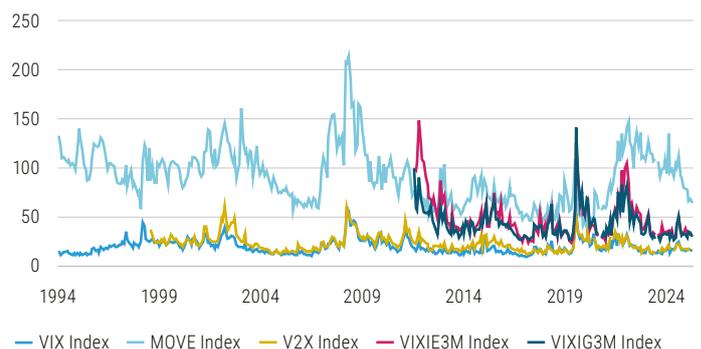
Volatility indicators

We look at various volatility indicators to assess the premium investors are willing to pay for protection from adverse market movements and use this as a gauge of the broader investor risk appetite. This is also because owning a corporate bond can conceptually be seen as economically equivalent to owning a risk-free bond and having sold a put-option on the assets of that same company.

On this basis, we note that implied volatility in IG credit and equity markets remains below long-run averages. Meanwhile, implied volatility on US Treasuries has fallen back to below its long-run average after the large rise of uncertainty around monetary policy seen in 2022-2023 (Figure 9).

We view these conditions as indicative of a lower-than-average risk aversion and as such are supportive for IG spreads. Note that long periods of low volatility could be seen as a contrarian indicator that encourages leverage and more risk-seeking behaviour.

Figure 9: Implied volatility



Source: Bloomberg and Columbia Threadneedle Investments

Credit themes

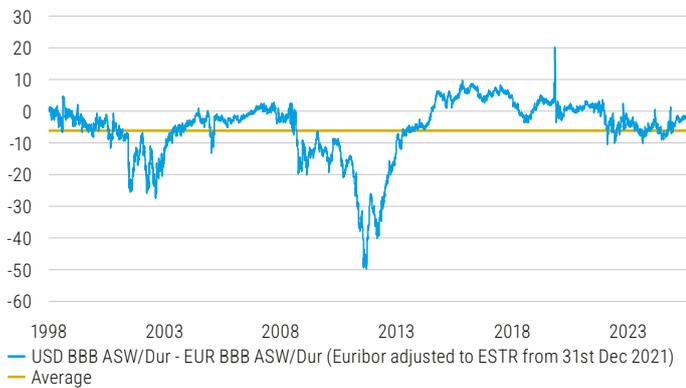
EUR versus USD

One of the interesting themes in IG in 2025 was the underperformance of US dollar spreads compared to euro spreads. Looking back at history (Figure 10) we note the clear underperformance of euro IG spreads in 2011-12 during the eurozone crisis, followed by a period from 2014-2022 when US dollar spreads looked more attractive on this high-level comparison. During the aggressive interest rate increases in 2022 and the European gas crisis in the wake of the Russia-Ukraine war, euro spreads underperformed.

There was a partial reversal in 2025 as euro spreads outperformed US dollar ones. Euro IG option-adjusted spreads (OAS) tightened 22bps, as did asset-swap spreads (ASW), while the US dollar IG OAS tightened 4bps (with ASW tightening 10bps). Typically, there is a home bias with domestic issuers trading at a lower spread in their home currency. Sometimes, however, there are big dislocations, which is another source of alpha for global active managers.

With the reversal in 2025 we have reduced our overweight to euro and underweight to US dollar credit risk.

Figure 10: US dollar spreads versus euro spreads



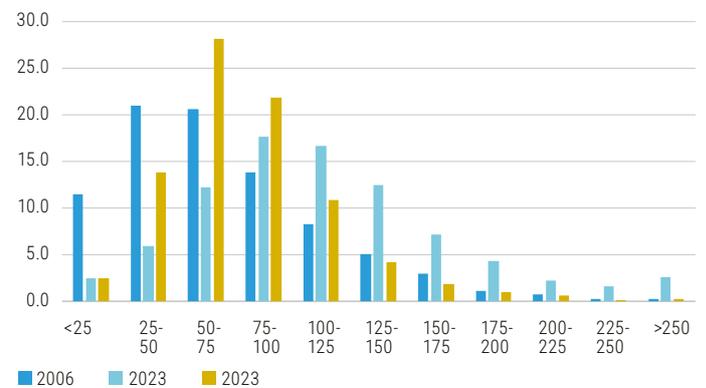
Source: Bloomberg and Columbia Threadneedle Investments, October 2025. US\$ BBB ASW/Dur versus EUR BBB ASW/Dur (Euribor adjusted to ESTR from 31 December 2021)

Dispersion

Credit spreads are rich and, with the exception of the Liberation Day sell-off, ground tighter in 2025. A consequence of this is that dispersion within IG has also fallen. This means more bonds are trading closer to each other and the additional compensation (spread) available on lower credit quality issuers compared to higher quality issuers has narrowed.

One way to show this is to compare a snapshot of the index at different points in time. For example, at the end of 2023 about 35% of the index was trading on a spread above 125bps. At the end of 2025 that had fallen to less than 10% (Figure 11). This isn't happening in a vacuum; credit fundamentals are in good shape and demand for the asset class is supportive. We have also included 2006 as an illustration of where spread distribution was when spreads hit all-time tights. Note the percentage of the index above 125bps is about the same today, but we currently have a higher proportion of bonds in the 50-125bps range, and fewer are trading at less than 50bps.

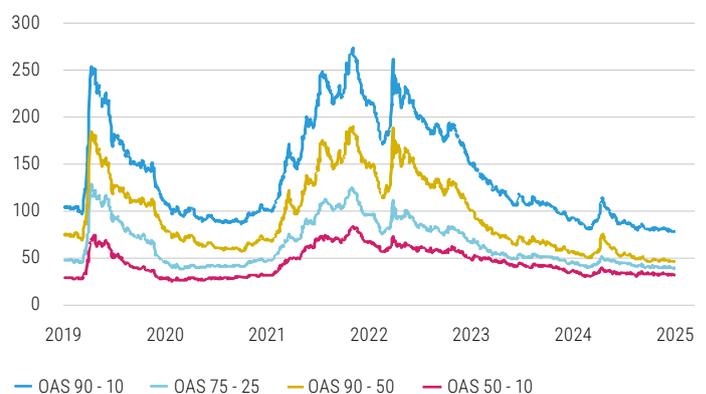
Figure 11: Risk dispersion across maturity buckets



Source: Bloomberg, BofAML Indices and Columbia Threadneedle Investments

Another way to measure the distribution of spreads within the index is to calculate the spread level that corresponds to a certain percentile and compare them over time. In Figure 12 we have plotted a few of these: for example, "OAS 90-50" looks at the difference in spread between the 90th percentile and 50th percentile (median). In 2022 that reached almost 200bps. Currently, that difference is only 50bps.

Figure 12: Spread distribution



Source: Bloomberg, BofAML Indices and Columbia Threadneedle Investments, as of 31 December 2025

2. Columbia Threadneedle Investments, Investment grade credit: Positioning for decompression, 19 December 2025

As an active credit manager, to generate alpha from issuer and security selection we need to have a different view to the market – either by thinking a security is trading at a spread that is too wide or too tight. When dispersion is high (as it was, say, in 2022) there are a wide range of opinions and therefore plenty of opportunities to identify issuers and securities that are, in our opinion, trading at the wrong spread. For example, if it is our assessment that the difference between two issuers is too wide, we can switch into the one with a higher spread – earn the extra spread and benefit if spreads compress.

In an environment where more bonds are trading closer to one other, and the additional spread available on poorer quality credits is low, we are more likely to view a larger portion of lower quality bonds as trading too close to higher quality ones. In this case, the risk/reward would favour switching the other way – that is, into higher quality issuers and in doing so only giving up a little spread. That trade will generate alpha if spreads decompress – ie if the lower quality issuer widens relative to the higher quality one. Unlike the previous example where we earn the higher spread until bonds compress, in the “up-in-quality” trade we give up a little bit of spread until they decompress.

In aggregate, most opportunities in IG are therefore in identifying issuers and securities to avoid. That will pay off when the market view changes and more spread is required to take on more risk. Given the asymmetric nature of credit (fixed upside) there is only limited additional upside to be had from investing in lower quality credits.

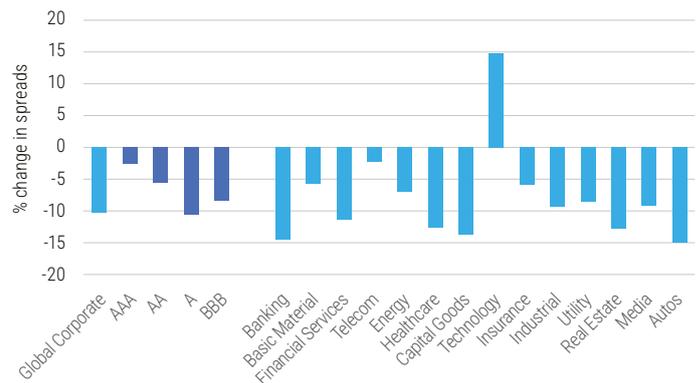
Alternatively, one could believe that spreads should compress even further. In our opinion, to see a return to the compressed levels of 2006 there would need to be continued solid and improving fundamentals, continued supportive demand/supply dynamics, and a lack of risk aversion. Given current geopolitical uncertainty, large and partially debt-funded AI capex expectations and the relatively short period of time since the last volatility spike, we struggle to make the argument for a return to these levels in the near term.

This is supportive for bottom-up driven investment processes looking to capture alpha opportunities between sectors, issuers or even between bonds from the same issuer. As a result we are positioned for decompression², giving up minimal income and investing in higher quality issuers that should weather a sell-off better and benefit from such an occurrence.

Sector performance

Last year, global IG spreads tightened 10% with a risk-adjusted outperformance of A and BBB over AA and AAA (spreads compressed). Within that, technology stands out with spreads having widened 15%, while autos, banks and capital goods outperformed having tightened 15% (Figure 13).

Figure 13: Sector % spread moves in 2025



Source: Bloomberg, BofAML Indices and Columbia Threadneedle Investments, as of 31 December 2025

Sector thoughts

Tech supply

The AI infrastructure build-out is not just a technological revolution – it’s a capital markets event of historic proportions, akin to the railroads in the late 1800s and the internet a generation ago. As AI applications proliferate, the race to build the infrastructure supporting them has triggered one of the largest capex cycles in recent history.

This surge is being driven by explosive growth in consumer and enterprise demand for AI-powered services. We estimate the required cumulative investment between 2025 and 2030 to approach \$5.8 trillion. This massive build-out creates unprecedented financing requirements. While technology giants generate substantial operating cash flow, the sheer scale of investment needed is pushing companies to explore multiple funding avenues. This includes:

Traditional corporate debt: Companies are issuing more bonds, but index concentration and risk premiums are rising as technology’s share of the corporate bond market grows.

2. Columbia Threadneedle Investments, Investment grade credit: Positioning for decompression, 19 December 2025

Securitised credit structures: Data centre assets are increasingly packaged into securities. These bonds are structured such that the principal repayment is reliant on refinancing. While attractive versus IG-rated corporate bonds for their yield and rating, relative value versus other securitised products deserves more nuanced discussion and the transparency remains limited.

Joint ventures and off-balance sheet structures: Innovative deals, such as the Oracle-Vantage-OpenAI structure, involve complex arrangements where infrastructure is funded by guarantees and revenue streams from multiple parties.

Asset-based lending: Data centres themselves are increasingly used as collateral, though valuation volatility and technological obsolescence are key concerns.

For fixed income investors, the proliferation of new structures requires careful underwriting. Investors must assess not just the credit quality of the issuer, but also the durability of the underlying assets, the strength of tenant contracts and the refinancing environment at maturity.³

US banks (NDFI, deregulation)

Recent developments in US banking underscore three critical themes: changes in capital rules are evidence of deregulation; weakening Fed oversight; and accelerating loan growth to NDFIs. All of these heighten overall sector risk while spreads for the US banking sector remain at historically tight levels with minimal quality dispersion.

In late 2025, regulators scaled back Basel banking reforms, reducing the projected capital increase for large banks from nearly 19% to about 9% after industry pushback. Adjustments to the enhanced supplementary leverage ratio and Tier 1 capital requirements ease constraints on systemically important banks, freeing capital for lending, share buybacks and dividends. As the sector is starting from a point of immense strength, aggregate capital remains strong. But these changes could erode resilience during stress and signal a shift toward lighter-touch regulation.

Oversight deterioration compounds this risk. A review by the congressional auditing agency flagged weaknesses in the Fed's escalation process, citing delays in addressing the vulnerabilities that contributed to the collapse of Silicon Valley Bank. More recently, the Fed announced plans to cut supervisory staff by roughly 30%, from 500 to 350 – the lowest level since 2011. Officials claim this streamlining will sharpen focus on material risks, but former regulators caution that shrinking resources during a period of heightened complexity undermines effective supervision. This reduction coincides with growing exposures to emerging risks, raising questions about whether the Fed can maintain robust oversight as banking models evolve.

Meanwhile, banks are deepening ties with NDFIs at an unprecedented pace. Outstanding loans to non-banks such as private credit funds, mortgage companies and broker-dealers reached around \$1.3 trillion by Q3 2025 – an increase of around 400% since 2015 – and now represents around 11% of total loans. Additionally, growth is concentrated among the largest institutions, with 25 of the largest US banks accounting for 88% of these exposures. This surge reflects strategic capital optimisation as banks seek higher yields and lighter regulatory burdens through partnerships with less-regulated entities. These relationships embed credit risk in opaque structures that are difficult to track and assess in real time.

These developments are a clear example of regulatory arbitrage at work. By channeling credit to NDFIs, banks exploit gaps between traditional oversight and the shadow banking sector. While these arrangements boost profitability, they introduce opaque credit risks that may surface under stress. Regulators have responded with incremental measures, such as requiring detailed NDFI disclosures for banks with more than \$10 billion in assets, and exploring stress tests focused on non-bank exposures. Yet, the pace of growth and complexity of these linkages outstrip current safeguards, leaving systemic vulnerabilities largely unaddressed.

In sum, easing capital rules, diminished supervisory capacity and aggressive NDFI lending collectively increase banking sector credit risk. These forces point to a system that appears resilient on the surface, but underneath is becoming more sensitive to adverse shocks. Growing linkages between banks and the non-bank financial sector heighten the likelihood that shocks emerging outside traditional oversight feed back into the regulated banking system. However, banking sector spreads remain near historical tights, offering little margin of safety against these accumulating risks. In this context, any deterioration in macro conditions or disruption within non-bank credit markets could prompt a rapid reassessment of risk, exposing vulnerabilities not currently reflected by the market.

Utilities

A major theme for 2026 is the continued rise in capital expenditures within utilities, which are expected to be 20%-30% higher than already elevated 2025 levels. This reflects not only the integration of large load demand from data centres, but also substantial investment in system resiliency, modernisation, and the replacement of ageing transmission, distribution and generation infrastructure. While regulatory support remains constructive, particularly around timely recovery of costs and flexible funding plans that include equity issuance and hybrid securities, credit profiles are more dependent on consistent regulatory outcomes and disciplined execution of large capital programs.

3. Columbia Threadneedle Investments, Bond investors join the AI infrastructure boom, 31 October 2025

Affordability remains the central concern for stakeholders, and the scale of planned investment keeps upward pressure on rates. Incremental load from data centers provides some mitigation by spreading fixed system costs across a larger base. These customers are generally expected to fund their share of infrastructure needs. However, demand growth alone will not fully offset rising energy costs, inflationary labour and equipment pressures, or the higher cost of capital. This leaves affordability as a key constraint in regulatory proceedings throughout 2026.

Resource planning is also evolving. In regions facing near-term reliability constraints, some utilities are modestly delaying coal retirements to maintain system stability. Meanwhile, incremental generation reflects an “all of the above” approach, including new natural gas-fired capacity, nuclear up-rates and continued investment in renewables. This diversified approach is designed to accommodate rising baseload and peak demand while preserving reliability during a period of rapid load expansion.

Despite an expectation of a busy year of heavy capex and regulatory activity, utilities remain well positioned with solid cash-flow predictability, manageable credit trajectories and multi-year investment visibility. Issuer selection is increasingly important, favouring companies operating in constructive regulatory environments with credible capital execution capabilities and balanced funding plans. Overall, the sector’s outlook for 2026 remains stable, reflecting both enduring financial resilience and the growing challenges associated with unprecedented capital needs and heightened affordability pressures.

M&A

As mentioned earlier, M&A has been through a three-year cyclical trough as the corporate sector digested the impact of higher interest rates. Green shoots are now emerging across several sectors.

M&A will remain a hot topic for European telecommunications following the non-binding rejected offer for Altice France and Telefonica’s more positive tone on consolidation, both of which leave the door open for more deals in Europe. The European Commission’s consultation on merger guidelines is of particular importance for the sector, with more positive regulatory dynamics anticipated. A more supportive framework would be positive for the sector, assuming remedies are limited and companies do not overpay, as it would limit churn, reducing the competitive landscape. Deals should generally be well received, improving business risk profiles and not leading to rating downgrades.

A desire to both expand global streaming reach and exit legacy cable assets should drive media M&A activity in 2026. Most notable is the ongoing battle for Warner Brothers Discovery assets between Netflix and Paramount Skydance. Other

candidates to change the media landscape include NBC Universal (NBCU), which is currently part of Comcast Corp and has recently unburdened itself of its shrinking cable assets. NBCU has the potential to be a noteworthy consolation prize for whoever misses out on Warner Brothers.

Recent months have seen a renewed wave of mining sector M&A, led by landmark transactions such as Anglo American-Teck. Although the proposed Rio Tinto-Glencore tie up collapsed. The strategic driver behind these moves is clear: copper. As a foundational metal for AI, electrification and semiconductor expansion, securing long-term copper supply has become imperative – particularly given limited new deposits and lengthy development cycles. Inorganic growth is therefore the most effective path to scale. At the same time, persistently strong gold prices and operational issues have encouraged exploratory discussions as miners seek exposure to long-term value. The key question is whether additional large scale deals will follow, especially for premium copper or gold assets.

In the banking sector there has been plenty of smaller scale M&A activity in Italy, Spain, the UK and the US. These would be dwarfed by the potential UniCredit/Commerzbank merger, which could be the industry’s first large cross-border transaction in many years.

Autos

The largest global original equipment manufacturers (OEMs) face a transformed regulatory landscape in 2026 that eases immediate compliance pressures while complicating long-term investment strategies. In the US, diluted Environmental Protection Agency greenhouse gas standards and revised Corporate Average Fuel Economy targets reduce immediate costs for the likes of Ford, GM, Toyota, Stellantis and Honda. This will allow profitable internal combustion engine (ICE) models to continue while better aligning electrification to consumer demand rather than regulatory mandates. Similarly, Europe’s shift from 100% to 90% zero-emission requirements by 2035 gives VW, BMW, Mercedes and Stellantis breathing room to extend hybrid and efficient ICE lifecycles, supporting margins as electric vehicle (EV) adoption normalises organically.

However, these policy resets extend what is already an elevated capex cycle. With loosened mandates, OEMs must maintain costly dual-track investments – advancing EV platforms, battery systems, and software-defined architectures while simultaneously developing and homologating ICE and hybrid powertrains. This prevents the capital efficiency gains that would come from concentrating spend on a single technology path. Competitive pressure from Chinese manufacturers and potential mature-node semiconductor constraints (particularly power and analog integrated circuits) further compel ongoing investments in supply-chain resilience and reinforce higher baseline capex requirements through 2026.

An underdeveloped catalyst for German OEMs is Europe's renewed defence-spending priority. Germany's budget committee approved approximately €50 billion in new procurement in December 2025. Policymakers are formalising EU mechanisms to channel investment into defence and dual-use capabilities, creating partnership opportunities that could leverage automotive manufacturing capacity for logistics trucks, specialised platforms and components in national programs.

Chemicals

Chemicals are used in virtually all manufactured products and in many steps in production processes: from plastic pellets that get molded into shapes and become parts of toys, to gaseous forms that are used in the production of semiconductors or food packaging. The term "chemicals" is used to describe companies engaged in very different activities and with distinct customer groups. Within the context of IG bond indices, the most significant companies are the producers of commodity chemicals. These firms are significantly affected by the supply and demand balance, with supply taking a considerable period to adjust, and demand potentially changing at any time. Over the past few years this balance has been detrimental to chemical company financial results. Sales of commodity chemicals tend to loosely follow economic growth. There are other key factors, but as a rough guide, as manufacturing increases, so does the demand for chemicals.

During the past two years, industrial production and global GDP have grown. But that growth has not been rapid enough to compensate for increased supply. Within Europe specifically, a couple of events have caused chemicals production to become much more expensive, as well as more challenging. Europe's response to the war in Ukraine has resulted in far more expensive inputs to the chemical process, such as energy imported from sources other than Russia. More challenging environmental regulations have also increased cost and complexity and hindered the demand of some large users of chemicals, for example the autos industry. A global situation that has not been robust enough, and a regional situation in Europe that has been very hard, has caused large manufacturers such as BASF and LyondellBasell to significantly change what they produce in Europe.

Within the chemicals sector the OAS is high relative to the OAS level of the general corporate index. In absolute terms, the chemicals sector spread has trended lower, in sympathy with the rest of the IG market. Unlike, for example, the high yield market experience, chemicals are an area where one can search for value, but they are not exceptionally cheap relative to other sectors or their own history.

In recent weeks, the senior management teams of the largest chemicals producers have highlighted a reduction in capacity of some of the bulk commodity chemicals. This has been predominantly but not exclusively in Europe. This capacity rationalisation will help the supply/demand situation, relative to what it would otherwise be. Global reductions of about 10% in certain key chemicals have been cited. The IG team is projecting corporate growth rates that are better than stable in 2026 and, all else being equal, that should support chemicals producers.

The large IG commodity chemicals producers have significant financial resources in addition to their low cost of production. With that comes the ability to wait for the inevitable rebalancing of supply and demand. We think the sector has strong growth potential in the year ahead, but given the unavoidable fact that it is a sector that is highly dependent on macro factors, we will take exposure through well-researched, bottom-up opportunities, not via broad, generic sector positioning.

Meet the Investment grade team

At Columbia Threadneedle Investments we pride ourselves on a robust investment process based on high-quality independent credit research. This is carried out by a large and experienced team of sector specialists dedicated to IG who work together to leverage more than 20 years of average experience. Our investment process embeds downside risk management at the outset, which is paramount in an asymmetrical asset class.

Feel free to contact us if you have any feedback or questions on the outlook or wish to understand more about our views or strategies.

Global Investment Grade Portfolio Management Team

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20 years average experience

13 professionals

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Mary Titler, CFA, Senior Analyst North American Utilities

18 years average experience

18 research professionals

Source: Columbia Threadneedle Investments, as at 31 December 2025. Certain team members may be employees of affiliated companies acting under the Columbia Threadneedle Investment brand.

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